

TO: ALL NON-PARTICIPATING TOBACCO PRODUCT MANUFACTURERS

FROM: MICHAEL PLUMLEY, ASSISTANT ATTORNEY GENERAL

DATE: JUNE 8, 2006

RE: VOLUNTARY ASSIGNMENT OF ESCROW DEPOSITS

On April 11, 2006, HB 380 passed by the Kentucky Legislature. On April 24, it was signed into law with some items vetoed by the Governor. Part of HB 380, the Budget Act, included a provision which could affect your business.

Attached hereto, is a copy of the section added to the escrow statute at KRS 131.602(4-6). What this provision allows for is giving non-participating manufacturers the option of making an irrevocable assignment of its interest in any escrow funds which are placed into an account for the benefit of Kentucky based on sales of cigarettes here. The provision allows for amendment of the escrow agreement to permit such assignment of rights and withdrawal of funds under a written assignment.

Any escrow funds which are assigned to the Commonwealth give a dollar for dollar credit against any judgment or settlement which this Commonwealth obtains against the non participating manufacturer on any released claim.

Should you have questions about this provision, please contact me at any time at the address below. It is advisable that you seek legal counsel on the tax and other consequences of the assignment prior to agreeing to do so.

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PART XIX

VOLUNTARY ASSIGNMENT OF MSA TOBACCO ESCROW PAYMENTS

Notwithstanding KRS 48.310, the following statute is amended to read as follows and shall have permanent effect, subject to future actions by the General Assembly:

Section 1. KRS 131.602 is amended to read as follows:

- (1) Any tobacco product manufacturer selling cigarettes to consumers within this state, whether directly or through a distributor, retailer, or similar intermediary or intermediaries, after June 30, 2000, shall do one (1) of the following:
 - (a) Become a participating manufacturer, as that term is defined in section II(jj) of the master settlement agreement, and generally perform its financial obligations under the master settlement agreement; or
 - (b) Place into a qualified escrow fund by April 15 of the year following the year in question the following amounts, as such amounts are adjusted for inflation:
 1. For 2000: \$0.0104712 per unit sold after June 30, 2000;
 2. For each of 2001 and 2002: \$0.0136125 per unit sold;
 3. For each of 2003 through 2006: \$0.0167539 per unit sold; and
 4. For 2007 and each year thereafter: \$0.0188482 per unit sold.
- (2) A tobacco product manufacturer that places funds into escrow pursuant to subsection (1)(b) of this section shall receive the interest or other appreciation on such funds as earned. Such funds themselves shall be released from escrow only under the following circumstances:
 - (a) To pay a judgment or settlement on any released claim brought against such tobacco product manufacturer by Kentucky or any releasing party located or residing in Kentucky. Funds shall be released from escrow under this paragraph in the order in which they were placed into escrow and only to the extent and at the time necessary to make payments required under such judgment or settlement;

- (b) To the extent that a tobacco product manufacturer establishes that the amount it was required to place into escrow on account of units sold in the state in a particular year was greater than the master settlement agreement payments, as determined pursuant to section IX(i) of that agreement, including after final determination of all adjustments, that such manufacturer would have been required to make on account of such units sold had it been a participating manufacturer, the excess shall be released from escrow and revert back to such tobacco product manufacturer; or
 - (c) To the extent not released from escrow under paragraph (a) or (b) of this subsection, funds shall be released from escrow and revert back to such tobacco product manufacturer twenty-five (25) years after the date on which they were placed into escrow.
- (3) Each tobacco product manufacturer that elects to place funds into escrow pursuant to subsection (1)(b) of this section shall annually certify to the Attorney General that it is in compliance with subsections (1)(b) and (2) of this section. The Attorney General may bring a civil action on behalf of Kentucky against any tobacco product manufacturer that fails to place into escrow the funds required under this section. Any tobacco product manufacturer that fails in any year to place into escrow the funds required under this section shall:
 - (a) Be required within fifteen (15) days to place such funds into escrow as shall bring it into compliance with this section. The court, upon a finding of a violation of subsection (1)(b) or (2) of this section, may impose a civil penalty, to be paid to the general fund of Kentucky, in an amount not to exceed five percent (5%) of the amount improperly withheld from escrow per day of the violation and in a total amount not to exceed one hundred percent (100%) of the original amount improperly withheld from escrow;

- (b) In the case of a knowing violation, be required within fifteen (15) days to place such funds into escrow as shall bring it into compliance with this section. The court, upon a finding of a knowing violation of subsection (1)(b) or (2) of this section, may impose a civil penalty, to be paid to the general fund of Kentucky, in an amount not to exceed fifteen percent (15%) of the amount improperly withheld from escrow per day of the violation and in a total amount not to exceed three hundred percent (300%) of the original amount improperly withheld from escrow; and
- (c) In the case of a second knowing violation, be prohibited from selling cigarettes to consumers within Kentucky, whether directly or through a distributor, retailer, or similar intermediary, for a period not to exceed two (2) years.

Each failure to make an annual deposit required under this section shall constitute a separate violation.

(4) Notwithstanding the provisions of subsection (2) of this section, a tobacco product manufacturer that elects to place funds into escrow pursuant to subsection (1)(b) of this section may make an irrevocable assignment of its interest in the funds to the benefit of the Commonwealth of Kentucky. Such assignment shall be permanent and apply to all funds in the subject escrow account or that may subsequently come into such account, including those deposited into the escrow account prior to the assignment being executed, those deposited into the escrow account after the assignment is executed, and interest or other appreciation on such funds. The tobacco product manufacturer, the Attorney General, and the financial institution where the escrow account is maintained may make such amendments to the qualified escrow account agreement as may be necessary to effectuate an assignment of rights executed pursuant to this subsection or a withdrawal of funds from the escrow account

pursuant to subsection (5) of this section. An assignment of rights executed pursuant to this subsection shall be in writing, signed by a duly authorized representative of the tobacco product manufacturer making the assignment, and shall become effective upon delivery of the assignment to the Attorney General and the financial institution where the escrow account is maintained.

(5) Notwithstanding the provisions of subsection (2) of this section, any escrow funds assigned to the Commonwealth pursuant to subsection (4) of this section shall be withdrawn by the Commonwealth upon request by the Treasurer of the Commonwealth and approval of the Attorney General. Any funds withdrawn pursuant to this subsection shall be deposited in the general fund and shall be calculated on a dollar-for-dollar basis as a credit against any judgment or settlement described in subsection (2)(a) of this section which may be obtained against the tobacco product manufacturer who has assigned the funds in the subject escrow account. Nothing in this subsection or in subsection (4) of this section shall be construed to relieve a tobacco product manufacturer from any past, current, or future obligations the manufacturer may have pursuant to this chapter.

(6) Notwithstanding subsections (4) and (5) of this section, no assignment of escrows created pursuant to subsection (1)(b) of this section shall be made by a tobacco product manufacturer, or shall be accepted by the Treasurer of the Commonwealth, unless and until the Attorney General has provided an opinion to the Treasurer, with a copy of the opinion provided to the Governor and the Legislative Research Commission, that amendments to KRS 131.600 and subsections (4) and (5) of this section will not jeopardize the Commonwealth's payments under the master settlement agreement in the form of a nonparticipating manufacturer adjustment.